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Impact of Corporate Governance on Financial Performance: A Study on DSE listed Insurance Companies in Bangladesh

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Abstract

Corporate governance involves promoting the compliance of law in letter spirit and demonstrating ethical conduct. This study is conducted to examine the impact of corporate governance on the performance of insurance companies. The respective study is conducted to apprehend the relationship between corporate governance mechanisms (board size, board composition, board meetings and board audit committee) and performance of the insurance company. The population for this study defined as listed insurance companies in DSE. The sample comprises of 10 listed insurance companies. Various tests like- Descriptive analysis, multiple linear regression, Pearson correlation and collinearity statistics have been performed using IBM SPSS statistics software. Mainly secondary sources of data are using for the period of 2010 to 2016. This study finds that the corporate governance has an impact on the performance of the insurance sector in Bangladesh. The independent variables of corporate governance (board size, board composition, board meetings and board audit committee) determine 38.20 percent of the performance (ROE) variance. Using Pearson correlation, the results provide evidence of a positive relationship between board sizes and ROE as well as board meetings. The result further reveals that a negative relationship between ROE and board composition. However, the study could not provide any association between performances of the insurance (ROE) and board audit committee.

Index terms— corporate governance, listed insurance companies, board size, board audit committee, board composition, and return on equity.

1 Introduction

he effect of corporate governance on organization's performance is a crucial issue since the last financial distress over the world. Many accounting scandals and numerous cases of corporate governance malpractice brought about more attention to corporate governance along with business integrities issues. Thus the issue of corporate governance is a serious factor in economic growth and financial markets steadiness. "Corporate Governance is the system by which organizations are directed and controlled" (Uk-Cadbury Report, London 1992) [7] . Various notable corporate scandals and collapses like-Enron, WorldCom, etc., where there is an attachment of unethical practices, and people are now pensive about their present and future protection for various purposes like health protection, educational protection and so on. Insurance companies are providing those opportunities to make it real. They provide unique financial services to the growth and development of every economy. Now people are concerned about the performance of the entity where they invest their money. Though the stringent governing framework, organization performs a weak role in practicing corporate governance code of conduct. "Corporate governance creates a set of relationship between a company's management, its board, its shareholders and other stakeholders by providing a structure through which the objectives of the company are determined and the means of attaining the objectives and monitoring the determined performance" (OECD-2004) [13] . Therefore this study is apprehended to establish a relationship between corporate governance and performance of insurance companies. It also measures how the insurance companies in Bangladesh are responding to the corporate governance guidelines set by the Bangladesh securities & Exchange Commission (BSEC) authority and finally the impact of corporate governance appliances on measuring the performance of the insurance companies in Bangladesh. However, the findings will provide data for the development of effective corporate governance practices in this sector.

2 II.

3 Literature Review

The study examined the relationship between four corporate governance mechanisms like board size, no. of independent director in the board, chief executive officer duality & board audit committee and value of the firm measure like ROA & ROE. The sample of this study were 93 DSE listed non-financial companies in 2006. The researcher of the study revealed a positive and significant relationship between ROA & Board Independent Director at 5% level and ROA and Chief Executive Duality at 10% level (Abdur Rouf, Md. 2011) [1] . But by using a Structural Equation Modeling the researcher arrived that some governance mechanisms had positive covariance, while some had negative covariance and thus the study appeared at no consistent and significant relationship between governance mechanisms and financial performance (Azim, M.I 2012) [6] . On the other hand, a study on 28 listed manufacturing firms in Sri Lanka exposed that there was no significant mean different between the firm performance among CG practices as board leadership structure, board committees, board meetings and proportion of non-executive directors (Achchuthan, S. & Kajananthan, R. 2013) [2] . The corporate governance and corporate financial performance were correlated and the governance ratings of the company had a significant positive impact on its financial performance, this research finding may support the decision of the company to improve its governance structure. In this paper, the researcher investigated the impact of corporate governance on corporate financial performance in an Indian context, using a sample of 20 companies listed on S&P CNX Nifty 50 Index during the year of 2010 to 2012 (Aggarwal, P. 2013) [3]. The researcher attempts to investigate the relationship between board mechanisms (audit committee size, audit committee composition, board size, and board composition) and firm performance (ROA) based on the annual reports of listed companies in the year 2011 of non-financial firms in the Saudi Market. For this study, data collected from a sample of 102 non-financial listed companies, and the study could not provide a significant relationship between the size of the audit committee and firm performance where it showed an insignificant relationship between board size and firm performance (AhidGhabayen, Md. 2012) [4] .However, Klein et al. (2005) [10] used four control variables, which were size, advantage, growth, profit variability and indicated that corporate governance does matter in Canada, and that size was consistently negatively related to performance. The linkage of corporate governance ratings and financial performance of the organization found positive but not significant (Van de Velde et al. 2005) [14] , and this observation found to be consistent with the findings of Gompers et al. 2003 [9] . A positive association between corporate governance scores (after adjusting for industry effects) and financial performance of firm (based on dividend payout, yield, profitability and shareholder returns) found in the study of Weir, Laing, and Mcknight (2012) [15] .

4 III.

5 Research Objectives

This paper aims to identify the practices in different corporate governance issues like the level of board size and its commitment to the corporate governance, effective board practices, and independent director and information disclosures along with corporate compliance annexure in the annual report. Along with this, the study aims to achieve the following objectives: 1. To examine the relation between corporate governance and financial performance of selected insurance companies; and 2. To provide an overview of corporate governance practices in the insurance sector in Bangladesh.

IV.

6 Research Methodology

Data Data on corporate governance practices and the insurance performance collected from mainly secondary sources. The secondary sources of data were found from Annual reports, DSE, Journal, and articles and company website, etc.

7 Sample

The sample comprises of ten (10) listed insurance companies from the population in Dhaka stock exchange for the periods of 2010 to 2016. The selected samples are mainly general insurance company. However, it is mentioned that insurance companies have been selected based on the availability of data on the corporate governance practices and insurance performance of the listed insurance companies in Bangladesh.

8 Data Analysis Tool

To interpret the data regarding the corporate governance practices of insurance companies the checklist of the selected sample companies is used. Various tests like-Descriptive Statistics, multiple regression analysis, correlation and collinearity statistics have been performed using IBM SPSS software to investigate the impact of corporate governance on the financial performance of the insurance companies.

9 d) Hypothesis Development H 1 :

There is a no relationship between board size and financial performance by insurance companies in Bangladesh.

H 2 : There is a no relation between the board composition and financial performance by insurance companies.

H 3 : There is a no relationship between board meetings and financial performance of insurance companies.

H 4 : There is a no relation between audit committee composition and performance of insurance companies.

V.

10 Research Model

The multiple linear regression model is used to examine the relationship between the performance of selected insurance companies in DSE and Board size, board composition, board meeting and audit committee. The result of regression analysis is an equation that represents the best prediction of a dependent variable from several independent variables. This method formulates when the independent variables are correlated with one another and with the dependent variable. The following regression equation is estimated as follow:Insurance performance= ?0 + ?1 BOD SIZE + ?2 BOD COMP + ?3 BOD MEET+?4 AC SIZE + ? Where VI.

11 Results & Discussion

The study presents the analysis of the relationship between CG variables and insurance company's performance variable using the data from the sample. Moreover, this chapter represents the findings of this study. The chapter has three sections. First, descriptive statistics, following by correlation analysis, then multiple linear regression are described. The final section discusses the results. The above table-2 shows that the mean of board size is approximately 16.01 with maximum twenty (20) and minimum ten (10) members. Regarding the BOD Size, the codes of corporate governance in Bangladesh require that the board of directors should consist of at least five (5) directors and twenty (20) directors as a maximum. BSEC also assert that one-fifth (1/5) of the board of directors in the company's board shall be independent directors. This table indicates that the average independent director number is 1.93 with standard deviation 98%. So the insurance company's no. of the independent director is an approximately 2 of the no. of the board of directors. Here, the mean of the board meeting is 7.46 with maximum 16 and minimum 4. Rules provide that the audit committee should have a minimum three (3) members in Bangladesh. The mean of audit committee size is 4.14 while the maximum and minimum are seven (7) and three (3) respectively. Therefore it is clear that the audit committee in the insurance companies in DSE have more than three members on average.

The following table represents the result of correlation variables regarding the impact of corporate governance on insurance performance. Source: Data manipulated by using SPSS Table 3 summarizes the correlation between the independent variables and dependent variables. The table displays that, BOD size and BOD meetings are positively related to the performance (ROE) of the insurance companies. The relationship between Board compositions (no. of the independent director) is significantly negative. However, audit committee (AC SIZE) is not related to the performance of the insurance companies and also show a negative relation on the table. Furthermore, the table also represents the correlation between the independent variables to each other. It shows no relationship between board size and audit committee. However, board size has a positive impact with Board composition and Board meeting which means that the size of the board of directors plays a significant role in determining the number of independent director.

Besides the table also reveals that Board composition (ID) has a significant positive relationship with the audit committee, which means that a large board composition leads to a large audit committee. However, the audit committee has no relation with other independent variables. Model summary: The table depicts the result that out of four variables three variables have the direct positive impact on output at one percent level of significance. Therefore, for one percent increase in Board size, Board meeting and Audit committee, the ROE is increased by 0.197, 0.474, and 0.057 percent respectively. Only one variable Board composition of independent director has a negative impact on output. It also implies that decreasing of one percent of BOD COMP will increase the ROE by 0.292 percent. The presence of multicollinearity, the study pursue with the value of VIF for the independent variables. It denotes that the VIF value for each independent variable is insignificant and less than ten which indicates the estimated result of the model for ROE concerning the independent variables Board size, Board composition, Board meeting and Audit committee is free from multicollinearity.

12 VII.

13 Findings

The table no. 3 denotes the result of CG variables (Board size, Board composition, Board meeting and Audit committee) and performance of insurance company (ROE). The first hypothesis states that the Board size and the insurance company's performance has no relationship. The analysis exhibits the Board size has positive relation with the performance and, the first hypothesis disproves. However, few studies found similar results of this study. Alhassan, Bajaher& Alsherhri (2015) investigated the relationship between Board size and performance of Banks (ROA) in Saudi listed banks during 2007-2012 using a sample of 10 listed banks and found that Board size had a positive association with the firm performance but not significant. The result indicated that larger boards were ineffective in enhancing financial performance in the context of Saudi banks.

The results of this study also reveal that there is a negative relation between board composition and performance. This result indicates that the second hypothesis is rejected. The second hypothesis is that there is no relationship between Board composition (No. of independent director in the board) and Insurance companies' performance. This negative relationship indicates that when the board composition increases, the performance of the company will decrease and viceversa. The research result is congruent with the study of Ahid Ghabayen (2012) where the researcher investigates the relationship between board composition and performance of non-financial firms in the Saudi market in the year 2011 using a sample of 102 listed non-financial companies and finds a negative relationship between board composition and firm performance.

The third hypothesis states that there is no relationship between board meetings and financial performance. Here the research rejects the third hypothesis. The study finds a positive and significant association between board meeting and performance and this result is consistent. The frequency of the board meeting to a large extent will ensure its effectiveness. When the board fails to convene regular meetings to deliberate issues of strategic importance, there will be no independence and accountability to the insurer. Circular resolutions are not perfect substitute for board meetings because they do not offer the opportunity for active debate over the issues circulated. Again, a biased presentation of the reasoning without an avail for the board members can create immediate questions or reservations. This may lead to make inappropriate decisions. The study could not provide a significant relationship between audit committee size and company performance which means that the fourth hypothesis is accepted. This result is in line with the research of Abdur Rouf (2011) who investigated the relationship between the size of AC and performance of the firm (ROA & ROE) in DSE in 2006 using a sample of 93 non-financial listed firms and the study revealed that there was no significant relationship between AC size and firm performance. However, the research result provides a view that the corporate governance have an impact on the performance of insurance companies in Bangladesh and the relationship may be positive or negative or no relation, but it has some influence in the commercial terms of the organization. Thus the Summary of the hypothesis results:

14 VIII. Conclusion & Recommendations

The study finds a correlation and corporate governance have a significant impact on financial performance. The insurance companies should combat to improve its performance along with indicators of corporate governance practices. However, the following recommendation can initiate an effective corporate culture in the insurance sector in Bangladesh. The insurance sector should commence massive awareness campaign through board meetings or other similar communication works like a seminar, workshop and, high lightening the meaning and the business case of good corporate governance. Although the size of the board is in line with best practices, special attention should come from the insurance companies in certain other areas. The board of directors should pay attention to overseeing the risk management and internal function of the insurance company. Awareness on the benefits of having an independent director on the board is of utmost importance and although the study finds a negative relation with ROE, the insurance company should recognize that appointing an independent director can protect the interest of its stakeholders. The insurance company should follow the rule of BSEC. Insurance companies should encourage the audit committee members to understand the role of the committees and should provide proper incentives.

15 IX.

16 Limitations

The study is subject to certain abridgements. First of all, the sample size is small and, that is 10 DSE listed insurance companies. Second, the period of this research is short (I.e., seven years) and the study unable to consider control variables like the capital intensity of the insurance company, leverage, risk, etc. Lastly, the research focuses only on a limited number of corporate governance variables (four variables) and one performance variables, so other variables are not in focus due to unavailability of the data. Therefore it is better for further

Table:1

Particulars	Variables	Description or Measurement
ROE	Dependent	(Net profit after tax ÷ Shareholders equity) × 100
BOD SIZE	Independent	Total no. of directors in the board
BOD COMP	Independent	No. of independent directors sitting on the board
BOD MEET	Independent	No. of meetings held
AC SIZE	Independent	Total member of an audit committee

Source: Data manipulated by using SPSS

Figure 1:

2

Variables	Mini.	Maxi.	Mean	Standard Deviation
BOD SIZE	10	20	16.01	3.02
BOD COMP	1	4	1.93	0.98
BOD MEET	4	16	7.46	2.51
AC SIZE	3	7	4.14	1.265
ROE	0.0106	0.4044	0.1344	0.07035

Figure 2: Table 2 :

3

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	ROE	BOD SIZE	BOD COMP	BOD MEET	AC SIZE
ROE					
Pearson correlation	1.00	.174	-.320	.538	-0.010
Sig (1-tailed)	.	0.74	0.003	.000	.468
N	70	70	70	70	70
BOD SIZE					
Pearson correlation	0.174	1.000	.171	.060	-.016
Sig (1-tailed)	0.074	.	.078	.310	.449
N	70	70	70	70	70
BOD COMP					
Pearson correlation	-.320	.218	1.000	-.169	.311
Sig (1-tailed)	.003	.078	.	.081	.004
N	70	70	70	70	70
BOD MEET					
Pearson correlation	.538	.060	-.169	1.000	.057
Sig (1-tailed)	.000	.310	.81	.	.320
N	70	70	70	70	70
AC SIZE					
Pearson correlation	-.010	-.016	.311	.057	1.000
Sig (1-tailed)	.468	.449	.004	.320	.
N	70	70	70	70	70

Figure 3: Table 3 :

4

R	R 2	Adjusted R 2	Std. Error	R 2 change	df1	df2	Sig. f change
.628 .382		.344	.05698	.382	4	65	.000

Source: Data manipulated by using SPSS

a) predictors: (constant), AC SIZE, BOD SIZE, BOD MEET, BOD COMP

b) Dependent Variable: ROE

The above table shows multiple linear regression which is related to ROE as a dependent variable. The table shows the influence of independent variable (Board of directors, Board composition, Board meeting and Audit committee composition) on the dependent variable (

Figure 4: Table 4 :

5

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(constant)	-.011	.047		-.233	.817		
BOD SIZE	.005	.002	.197	1.972	.053	.956	1.047
BOD COMP	-.021	.008	-.292	-2.730	.008	.833	1.201
BOD MEET	.013	.003	.474	4.473	.000	.948	1.054
AC SIZE	.003	.006	.057	.553	.582	.884	1.131

Source: Data manipulated by using SPSS

Figure 5: Table 5 :

6

Hypothesis	Relationship	Findings
H 1	Between Board Size and ROE	Positive Relationship
H 2	Between Board Comp-osition and ROE	Negative and Significant
H 3	Between Board Meeting and ROE	Positive and Significant
H 4	Between the Size of Audit committee and ROE	No Relationship

Figure 6: Table 6 :

research to select sample companies from an ample range even from non-financial listed companies, non-listed companies and so on. [1] [2]

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